1991

Rocky Mountain Energy Company v. Utah State Tax Commission : Brief of Appellee

Utah Supreme Court

Brian L. Tarbet; assistant attorney general; R. Paul van Dam; attorneys for respondent.
Robert A. Peterson; Van Cott, Bagley, Cornwall & McCarthy; attorney for petitioners.

IN THE SUPREME COURT OF THE STATE OF UTAH

ROCKY MOUNTAIN ENERGY CO., Petitioner/Appellant, vs. UTAH STATE TAX COMMISSION, Respondent/Appellee.	Case No. 910105

BRIEF OF APPELLEE UTAH STATE TAX COMMISSION

****

APPEAL FROM THE DECISION OF THE UTAH STATE TAX COMMISSION ISSUED FEBRUARY 13, 1991

ROBERT A. PETERSON
Van Cott, Bagley, Cornwall
& McCarthy
50 South Main Street, #1600
Salt Lake City, Utah 84145

Attorney for Petitioner

R. PAUL VAN DAM #3312
Attorney General
BRIAN L. TARBET #3191
36 South State Street
11th Floor
Salt Lake City, Utah 84111
Telephone: (801) 533-3200

Attorneys for Respondent

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R. PAUL VAN DAM #3312
Attorney General
BRIAN L. TARBET #3191
36 South State Street
11th Floor
Salt Lake City, Utah 84111
Telephone: (801) 533-3200

Attorneys for Respondent

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STATEMENT OF JURISDICTION

The Utah Supreme Court has jurisdiction over this appeal pursuant to Utah Code Ann. § 63-46b-16 (1990) and § 78-2-2(3)(e)(ii) (1990).

ISSUES PRESENTED FOR REVIEW

I. Whether the oral agreement permitting L.A. Young Construction Company ("L.A. Young") to remove tangible personal property in the form of slag material from Rocky Mountain Energy Company's ("RME") leasehold estate is a taxable transaction pursuant to Utah Code Ann. § 59-12-103(1)(a)(1987 & Supp. 1991).

II. Whether Rocky Mountain Energy Company's ("RME") sale of tangible personal property to L.A. Young is an exempt transaction as a sale to the State since RME negotiated with L.A.

Young for payment to be made by Utah Department of Transportation ("UDOT") checks jointly payable to L.A. Young and RME.

STANDARD OF REVIEW

This Court's standard of review for both issues is Utah Code Ann. § 63-46b-16(4)(d)(1990). Pursuant to § 63-46b-16(4)(d)(1990) this Court can grant relief if, on the basis of the agency's record, it determines that RME has been substantially prejudiced by an erroneous interpretation or application of the law by the Tax Commission. Thus the "correction of error" standard is applicable to the issues presented by this appeal. Chris & Dicks Lumber and Hardware v. Tax Comm'n, 791 P.2d 511 (Utah 1990).

DETERMINATIVE STATUTORY AND REGULATORY PROVISIONS

Utah Code Ann. § 59-12-103(1)(a)(1987 & Supp. 1991):

> (1) There is levied a tax on the purchaser for the amount paid or charged for the following:
> (a) retail sales of tangible personal property made within the state;

Utah Code Ann. § 59-12-102(13)(1987 & Supp. 1991):

> (a) "Tangible personal property" means:
> * * * *
> (iv) all other physically existing articles or things, including property severed from real estate.
> (b) "Tangible personal property" does not include:
> (i) real estate or any interest therein or improvements thereon;

Utah Code Ann. § 59-12-104(2)(1987 & Supp. 1991):

> The following sales and uses are exempt from the taxes imposed by this chapter:
> * * * *

(2) sales to the state, its institutions, and its political subdivisions;

Utah Admin. Code R865-19-42S (1991):

> 1A. Sales made to the state of Utah, its departments and institutions or to its political subdivisions such as counties, municipalities, school districts, drainage districts, irrigation districts, and metropolitan water districts are exempt from tax if such property [is] for use in the exercise of an essential governmental function. If the sale is paid for by a warrant drawn upon the state treasurer or the official disbursing agent of any political subdivision, the sale is considered as being made to the state of Utah or its political subdivisions and exempt from tax.

STATEMENT OF THE CASE

This case involves an appeal from the Tax Commission's Order issued from its Formal Hearing on February 13, 1991. At issue before the Tax Commission was whether RME was required to remit sales tax on its sale of slag material to L.A. Young.

RME's contention before the Tax Commission was that this transaction involved the conveyance of an interest in land, and was thus exempt from sales tax. The Tax Commission disagreed, and held that "[t]here was no evidence presented by the Petitioner which would substantiate the Petitioner's claim that the parties to the contract intended the purchase agreement to constitute the sale of an interest in real property rather than the sale of the slag material as tangible personal property." (R. 23.) (Addendum A attached).

RME's second argument before the Tax Commission was that these transactions should be exempt because it received

payment by way of a two-party check issued by UDOT to L.A. Young and RME as co-payees. The Tax Commission rejected this argument and held that the manner of payment required by RME did not change the transaction to one wherein RME sold the slag material to the State of Utah.

STATEMENT OF THE FACTS

The following facts were stipulated or established by testimony at the hearing before the Tax Commission.

1. RME leased from Kennecott Corporation ("Kennecott") the slag pile. (R. 69.)

2. L.A. Young, in bidding on a UDOT highway project, contacted RME for price quotes on the sale of slag material. (R. 69.)

3. RME offered L.A. Young two options in which to purchase the slag. Either RME would remove the material from the slag pile for L.A. Young at a fixed price, or L.A. Young could use its own equipment and remove the slag material itself in which case L.A. Young would pay RME $ .60 per ton. (R. 69-70.)

4. L.A. Young was the successful bidder on the UDOT project, and elected to remove the material itself from RME's slag pile. (R. 69.)

5. L.A. Young obtained from Kennecott a written easement which granted L.A. Young access across Kennecott's property to RME's slag pile. (R. 103-107.)

6. RME and L.A. Young had an oral agreement which gave

L.A. Young permission to remove slag from RME's leasehold estate. None of RME's agreement with L.A. Young was put in writing. (R. 39, 47.)

7. During the negotiations between RME and L.A. Young, RME insisted that L.A. Young make arrangements with UDOT so that RME would receive payment for the material from UDOT rather than L.A. Young. (R. 70.)

8. This manner of payment was accepted by all three parties. Throughout the project UDOT issued checks payable to both L.A. Young and RME. UDOT would give these checks to its contractor, L.A. Young, who would in turn endorse the checks and give the checks to RME in payment for the slag material removed by L.A. Young. (R. 70.)

SUMMARY OF THE ARGUMENT

The Tax Commission correctly held that RME's sale of slag material to L.A. Young involved the sale of tangible personal property and as such was properly assessed a sales tax pursuant to Utah Code Ann. § 59-12-103(1)(a)(1987 & Supp. 1991).

The sale transactions did not involve a transfer of a nontaxable interest in land as RME contends. There was no written agreement between the parties to transfer an interest in real property. The proper characterization of this transaction is a license granted to L.A. Young to remove the slag material. "A license is an authority or permission to do a particular act or series of acts upon the land of another without possessing any

interest or estate in such land." Tanner Companies. v. Arizona State Land Dep't., 688 P.2d 1075, 1085 (Ariz. App. 1984).

Further, the sale of slag material was a sale of tangible personal property by the mere fact that the slag material which L.A. Young had permission tc remove was material which had previously been severed from realty through the mining processes. This slag material was, therefore, tangible personal property even before L.A. Young loaded the material onto its trucks. Thus to characterize this transaction as RME selling L.A. Young an interest in land is incorrect.

RME's sale of material to L.A. Young is not exempt from taxation merely because UDOT paid for the material by means of two-party checks payable to L.A. Young and RME. The substance of the transaction over the form must be considered here. RME insisted upon payment in this manner because of L.A. Young's precarious financial position. RME negotiated only with L.A. Young and had no dealings with UDOT. The sole fact that RME received payment by means of a state warrant under these circumstances does not alter the fact that this was a sales transaction between RME and L.A. Young only.

ARGUMENT

I. THE SALE OF SLAG MATERIAL FROM ROCKY MOUNTAIN ENERGY TO L.A. YOUNG DID NOT INVOLVE A CONVEYANCE OF AN INTEREST IN REAL PROPERTY

RME's contention that the transactions between itself and L.A. Young involved a transfer of an interest in real property is without merit. RME claims its sale of slag material is a nontaxable transaction since Utah's sales tax is applied only on transactions of tangible personal property. RME relies upon Utah Code Ann. § 59-12-102(13)(b)(1987 & Supp. 1991) which states, "Tangible personal property' does not include: (i) real estate or any interest therein or improvements thereon; . . . ."

RME contends that a label on the transferred interest is not important in finding the transaction between RME and L.A. Young as nontaxable. While a conveyance of an interest in land is not a taxable event, it is necessary, when an alleged interest is at issue, to see if there was a conveyance, and if so what type of interest was transferred. Therefore, to properly analyze these transactions under § 59-12-102(13)(b)(1987 & Supp. 1991) it is necessary to label the interest, if any, RME conveyed to L.A. Young. For instance, if RME had deeded property to L.A. Young, or granted L.A. Young a lease, easement, or a profit a prendre, there would have been a transfer of an interest in land, and thus no sales tax assessed against RME. However, the record does not reflect facts which support a transfer of these types of

interests in land.

The Tax Commission was correct in labeling the permission RME gave to L.A. Young as a license. A distinction between a license and an interest in land was made in Radke v. Union Pac. R.R. Co., 334 P.2d 1077 (Colo. 1959),

> While under a lease an interest or estate in the land itself is created, under a license a licensee has no interest or estate in the land itself, but only in the proceeds, . . . not as realty, but as personal property, ... In general, a contract simply giving a right to take ore from a mine, no interest or estate being granted, confers a mere license . . .

Id. at 1086 (citing Saxman v. Christmann, 79 P.2d 520, 521 (Ariz. 1938), (emphasis added).

This language from Radke is highly relevant to the case at bar. In the present case, L.A. Young only had RME's permission to load slag onto its own trucks; in return L.A. Young was required to pay RME $.60 per ton. RME did not grant any specific interest in land to L.A. Young. RME was unable to produce any written documentation to support its claim that an interest in land was granted. Rather RME and L.A. Young had only an oral agreement which allowed the latter to remove slag from RME's stockpile.[1]

The theory behind the Tax Commission's holding is

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[1] Counsel for RME admitted that there was no written agreement between the parties by stating, "there is no formal written agreement, to the best of my knowledge, between R.M.E. and L.A. Young. It was more or less just an understanding." (R. 39.) (See also R. 47.)

supported by this Court's decision in Wasatch Mines Co. v. Hopkinson, 465 P.2d 1007 (Utah 1970). In Wasatch, the defendant's counterclaim asserted that he had received from the plaintiff a "right to the soil on the land, a profit a prendre, ..." Id. at 1010. The Court had before it a variety of documents relating to the parties' business agreements which involved the disputed interest in property at issue. Nonetheless the Wasatch Court affirmed the dismissal of defendant's counterclaim "since the documents d[id] not identify the grantor, the grantee, the interest granted, or a description of the boundaries in a manner sufficient to construe the instruments as a conveyance of an interest in land." Id.

The transaction between RME and L.A. Young does not meet the standard set forth by this Court in Wasatch. There is no document for the Court to properly apply the Wasatch test. Again it bears mentioning that RME had no written agreement, yet it claims that an interest in land was transferred. With no written agreement, this Court cannot ascertain the kind of interest granted nor the boundaries of the alleged interest. Thus the Tax Commission, basing its decision on the totality of the circumstances, found that the sale of slag material was a purchase of tangible personal property and did not involved a nontaxable transfer of an interest in land.

RME's argument also fails under the recent standard set forth in Heiner v. S.J. Groves & Sons Co., 790 P.2d 107 (Utah

App. 1990), for determining whether a conveyance of mineral interest exists in an agreement. In Heiner the court stated, "general principles governing the interpretation of contracts apply to documents conveying mineral interests. The cardinal rule is to give effect to the intentions of the parties . . . ." Id. at 110 (citations omitted).

Under the Heiner standard, the fact that there was no written agreement between RME and L.A. Young supports the conclusion that a license was granted to L.A. Young rather than an interest in real property. "It is presumed that a parol agreement to impress property with a servitude is made with knowledge of the Statute of Frauds and is therefore a license not an easement." Thompson on Real Property § 223, at 224 (1980 Replacement), see also Mueller v. Keiler, 164 N.E.2d 28 (Ill. 1960).

A mere oral understanding between RME and L.A. Young which permitted L.A. Young to remove slag does not rise to the level of an interest in land under the tests established by the Wasatch and Heiner courts. Thus the presumption of a license, under the facts of the present case, is appropriate and is supported by the facts.

The record further supports the Tax Commission's decision that the transactions involved the sale of tangible personal property rather than a transfer of an interest in land. The question posed to RME at the Formal Hearing was whether its

slag pile was personalty or realty given that the slag material, a waste product, had been previously severed from real property during the mining process. Counsel for RME responded, "I don't think that there's any question that once the rock is severed it's personal property. I'm not going to sit here and tell you that it's real property at that point." (R. 47.)

By RME's own admission, its argument is flawed. L.A. Young obtained an easement from Kennecott, (R. 103), which allowed L.A. Young access to the slag pile. RME claims that it granted an interest in real property to L.A. Young. However, L.A. Young only had oral permission to remove tangible personal property from RME's leasehold estate. This removal and sale of slag material does not amount to an interest in real property. L.A. Young had permission, properly labeled a license, from RME to remove slag material itself.[2]

II. ROCKY MOUNTAIN ENERGY'S REQUIREMENT THAT L.A. YOUNG PAY FOR THE MATERIAL BY A TWO-PARTY CHECK ISSUED FROM UDOT DOES NOT EXEMPT THE UNDERLYING TRANSACTION BETWEEN ROCKY MOUNTAIN ENERGY AND L.A. YOUNG FROM TAXATION

The payment procedure in this case required issuance of

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[2] Tanner Cos. v. Ariz. State Land Dept., 688 P.2d 1075 (Ariz. App. 1984) required the court to interpret what interest was transferred when the lessee under a government lease entered into an oral agreement with a third party which authorized the latter to remove clay from lessee's leasehold for 25 cents per ton. The court held, "[t]he agreement between the parties here was nothing more than a license. A license is an authority or permission to do a particular act or series of acts upon the land of another without possessing any interest or estate in such land." Id. at 1085.

a two-party check payable to L.A. Young and RME as co-payees. "The warrants were received by L.A. Young from UDOT. The warrants were endorsed by L.A. Young and handed over to RME, which was entitled to the full check." (Stipulation of Facts, R. 70.) The record of this case establishes that the method of payment was negotiated between RME and L.A. Young. Id. RME insisted "that L.A. Young make arrangements with UDOT to make payment for the slag material by means of naming RME as a payee on UDOT's checks" along with L.A. Young. Id. This manner of payment was arranged by RME because of its concern of L.A. Young's potential for nonpayment.

The procedure of payment in the present case does not alter the underlying contracts to change a taxable sale of tangible personal property between RME and L.A. Young to a nontaxable sale of material between RME and the State of Utah. In this instance, it is necessary to look at the underlying substance of the agreements between RME, L.A. Young, and UDOT rather than the outwardly appearing form of payment. As the Hawaii Supreme court stated, "it is well settled that in determining tax liability, the substance of a transaction rather than its form governs." Matter of O.W. Ltd. Partnership, 668 P.2d 56, 63 (Haw. 1983).

The substance of the underlying agreement is that RME did not negotiate with UDOT. Thus, RME was not a party to the contract between L.A. Young and UDOT. Further, the record is

devoid of any invoices or other documentation of sale between RME and UDOT. From this it follows that RME did not sell slag material to UDOT.

RME claims that the transactions involved a sale of personal property to the State. This claim is based on the sole fact that UDOT paid L.A. Young with a two-party check with RME designated as a co-payee. This claim is too narrow in focus, does not consider the totality of the circumstances and reaches an erroneous conclusion.

The Tax Commission correctly saw the underlying substantive agreements as follows: first, a contract between RME and L.A. Young for slag material; and second, a contract between L.A. Young and UDOT for services and material. Furthermore, the Tax Commission looked beyond the formalities and the reasons payment was structured in the manner it was, and considered the substance of the transaction. Its determination that the transaction between RME and L.A. Young is not an exempt sale simply because payment was made by a UDOT check should be upheld.

CONCLUSION

The Tax Commission was correct in classifying the agreement between RME and L.A. Young as a license which gave L.A. Young the right to remove tangible personal property from RME's leasehold estate. Thus the Tax Commission was correct in upholding the assessment of sales tax on these sale transactions.

Furthermore, the underlying arrangement between RME and

L.A. Young establishes that these transactions were taxable notwithstanding that RME received payment for the material by checks from UDOT made jointly payable to RME and L.A. Young.

The Tax Commission respectfully requests that its decision be affirmed.

DATED this 6TH day of December, 1991.

By _____
BRIAN L. TARBET
Assistant Attorney General
Attorney for Utah State
Tax Commission

CERTIFICATE OF MAILING

I hereby certify that on the 6TH day of December, 1991, ten (10) true and correct copies of the foregoing BRIEF OF APPELLEE UTAH STATE TAX COMMISSION were filed with the Supreme Court Clerk, and four (4) true and correct copies were mailed, postage prepaid, to the following:

Robert A. Peterson, Esq.
VAN COTT, BAGLEY, CORNWALL
& McCARTHY
50 South Main Street, #1600
Salt Lake City, Utah 84145

ADDENDUM A

BEFORE THE UTAH STATE TAX COMMISSION

ROCKY MOUNTAIN ENERGY CO., Petitioner,	)	ORDER
v.	)	
AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	)	Appeal No. 87-2039

STATEMENT OF CASE

This matter came before the Utah State Tax Commission for oral arguments on November 19, 1990, pursuant to the Petitioner's Motion for Summary Judgment. Paul F. Iwasaki, Presiding Officer, and Joe B. Pacheco, Commissioner, heard the matter for and on behalf of the Commission. Present and representing the Petitioner was James D. Douglass. Present and representing the Respondent was Brian L. Tarbet, Assistant Attorney General.

Based upon the memoranda submitted, and oral arguments of the parties, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. The tax in question is sales tax.

2. The audit period in question is from January 1, 1984, through December 31, 1986.

3. The Petitioner is a subsidiary of Union Pacific Corporation.

4. The Petitioner is engaged in the processing and selling of slag material it extracts from a slag pile which is leased from Kennecott Copper Corporation in Magna, Utah.

5. The Petitioner removes the slag by the use of a front-end loader, and loads the slag into trucks. The slag is transported to its facilities where the slag is crushed. The crushed slag is typically used for railroad ballast and fill material used in highway construction.

6. The slag pile is approximately 175 acres in size, which rises to approximately 100 feet higher than the surrounding terrain.

7. During the audit period, the Petitioner entered into an agreement with L.A. Young and Sons Construction Company to provide L.A. Young with slag to be used in the construction of a highway project that L.A. Young had agreed to perform for the Utah Department of Transportation (UDOT). At the choice of the construction company, the Petitioner would: (1) rip, doze, and load the material at a fixed price or; (2) the construction company could rip, doze, and load the material and pay the Petitioner 60 cents per ton. It was this second option that L.A. Young chose.

8. Based upon the choice of the second option by L.A. Young, L.A. Young was permitted to remove the material from a designated site within the slag pile area.

9. As the highway fill material was installed, UDOT paid for that fill material. Payment was made by warrants drawn on UDOT's account and, at the request of the Petitioner, said warrants were made payable to the Petitioner and L.A.

Young as co-payees. This procedure was done at the request of the Petitioner to ensure payment by L.A. Young.

10. As payments for the fill material were received by L.A. Young, L.A. Young endorsed the warrants and then submitted them to Petitioner as payment for the fill material purchased.

11. An informal hearing was held on this matter on October 5, 1988. An informal decision was rendered by the Commission, dated February 21, 1989, which affirmed the assessment of the Respondent and denied the request of the Petitioner. Thereafter, the Petitioner filed its appeal requesting a formal hearing in this matter.

12. Prior to formal hearing in this matter, the Petitioner requested that the matter be disposed of by way of its Motion for Summary Judgment, which formed the basis for this order.

CONCLUSIONS OF LAW

There is levied a tax on the purchaser for the amount paid or charged for retail sales of tangible personal property made within the state. "Tangible personal property" does not include real estate or any interest therein or improvements thereon. (Utah Code Ann. §§59-12-103 and §59-12-102.)

Sales made to the state of Utah are exempt from tax if such property was purchased for use in the exercise of an essential governmental function. If the sale is paid for by warrant drawn upon the state Treasurer or the official disbursing agency of any political subdivision, a sale is considered as being made to the state of Utah or its political

subdivisions and exempt from tax. (Utah State Tax Commission Administrative Rule R865-19-42S.)

DECISION AND ORDER

In the present case, the Petitioner argues that the purchases of the slag material by L.A. Young were exempt from sales tax for one of two alternative reasons: (1) Petitioner sold L.A. Young an interest in real property rather than a sale of tangible personal property, and thus was exempt from sales tax; or (2) the sale of the slag material was a sale to the state of Utah, and thus exempt from taxation.

Turning to the Petitioner's first argument, the Tax Commission finds that the sale of the slag material to L.A. Young was a sale of tangible personal property and not the sale of an interest in land. There was no evidence presented by the Petitioner which would substantiate the Petitioner's claim that the parties to the contract intended the purchase agreement to constitute the sale of an interest in real property rather than the sale of the slag material as tangible personal property.

Indeed, even the purchasing option offered to L.A. Young by the Petitioner would indicate that neither party intended this to be anything more than giving L.A. Young a license to enter onto the property to remove and extract the slag material. The Petitioner agrees that had L.A. Young chosen the first option, that is to have the Petitioner rip, doze, or load the material rather than performing those functions itself, the sale would constitute the sale of tangible personal property. Merely choosing the second option does not magically transform what is otherwise a sale of

tangible personal property into the sale of a real property right, nor does it change the character or nature of the slag removed.

It should be noted that the Petitioner was not able to provide the Commission with a copy of any agreement between the Petitioner and L.A. Young which would in any way indicate that the transference of some real property right had indeed occurred.

Turning next to the Petitioner's alternative argument, that the sale of the slag material was a sale to the state of Utah or one of its departments and thus exempt from taxation, the Tax Commission finds that this argument too is without merit.

As correctly pointed out by the Respondent in its brief and its oral argument, the mere fact that the Petitioner was named as a co-payee on the warrants issued by UDOT does not necessarily lead to the conclusion that the sale of the slag material was a sale to the state of Utah or that a contractual relationship existed between the Petitioner and the state of Utah.

As the Respondent points out, there were in fact two separate transactions conducted which must be viewed separately:

1. The agreement between the Petitioner and L.A. Young; and

2. The agreement between L.A. Young and the state of Utah.

The first transaction was a transfer of tangible personal property from the Petitioner to L.A. Young, which was

subject to sales tax. The second transaction was the performance of services by L.A. Young for the state of Utah, with payment made by the state of Utah to L.A. Young. The fact that the Petitioner was named as a co-payee on the warrant as a measure of protection for the Petitioner does not establish a contractual relationship between the Petitioner and the state of Utah whereby the Petitioner was selling its product directly to the state.

Based upon the foregoing, the Tax Commission finds that the sale of the slag material to L.A. Young constituted the sale of tangible personal property to a party other than the state of Utah, or any of its departments, or any of its political subdivisions, and therefore, was a sale subject to sales tax. Therefore, the Tax Commission affirms its prior decision which affirmed the assessment of the Respondent and denies the motion of the Petitioner. Judgment is entered in favor of the Respondent. It is so ordered.

DATED this 13 day of February, 1991.

BY ORDER OF THE UTAH STATE TAX COMMISSION.

R. H. Hansen
Chairman

Roger O. Tew
Commissioner

Joe B. Pacheco
Commissioner

G. Blaine Davis
Commissioner

NOTICE: You have twenty (20) days after the date of the final order to file a request for reconsideration or thirty (30) days after the date of final order to file in Supreme Court a petition for judicial review. Utah Code Ann. §§63-46b-13(1), 63-46b-14(2)(a).

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